

To: New Jersey Law Revision Commission
From: Jennifer Weitz
Re: Definition of “Award”
Date: October 7, 2019

MEMORANDUM

Executive Summary¹

In *Kite v. Director, Division of Taxation*, the Appellate Division considered whether a monetary recovery by a “relator” (a *qui tam* plaintiff) in an action filed under the False Claims Act, 31 U.S.C.A. § 3729 *et. seq.*, constitutes an award under New Jersey’s Gross Income Tax Act. The Court held that monies recovered by the *qui tam* plaintiff qualified as an award, and therefore were subject to state income tax pursuant to N.J.S. 54A:5-1(1) and that Plaintiff could not deduct legal fees from his state income taxes as he could from his federal income taxes.

Background

In 2004, Plaintiff Anthony Kite was performing financial consulting services for a number of hospitals when he discovered what he thought was a pattern of fraud.² Kite believed these hospitals were submitting false claims under the Medicare program by inflating charges, in some cases by 400 percent.³ After spending several months reviewing more than a million pages of documents and computerized data, Kite concluded that he had enough evidence to prove fraudulent activity.⁴ He retained a law firm to file and prosecute a *qui tam* action on behalf of the United States, which was filed in U.S. District Court for the District of New Jersey.⁵

The U.S. Department of Justice (“DOJ”) opted to intervene and prosecute plaintiff’s action.⁶ Subsequently, DOJ revealed two complaints filed by other relators, with the same allegations as Kite’s, and against some of the same hospitals.⁷ As a result, Kite and three other relators executed an agreement to work together to advance all three *qui tam* lawsuits, and to share all monies recovered as a result of their claims.⁸ In 2008 the United States recovered from defendant hospitals \$4.93 million.⁹ Kite’s share was \$1,229,255, including interest.¹⁰ After

¹ Original work was performed on this project by Ryan Schimmel during his tenure with the New Jersey Law Revision Commission.

² *Kite v. Director, Division of Taxation*, 453 N.J. Super. 146, 148 (App. Div. 2018); and below, *Kite v. Director, Division of Taxation*, 29 N.J. Tax 75, 77 (2016).

³ *Kite v. Director, Division of Taxation*, 29 N.J. Tax 75, 77 (2016).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 78.

⁷ *Id.*

⁸ *Id.* at 79.

⁹ *Id.* at 80.

¹⁰ *Id.*

deductions for legal fees and distributions to other relators, plaintiff received \$553,164.75.¹¹

The Internal Revenue Service issued plaintiff a 1009–Misc. showing income of \$1,229,255, which he reported on his 2008 federal income tax return as “other income.”¹² The amount paid to his attorneys was deductible from his federal income tax.¹³ However, Kite did not report the \$1,229,255 as part of his 2008 New Jersey income tax return.¹⁴ In 2012, the Division of Taxation informed plaintiff of the deficiency and notified him that the full \$1,229,255 was taxable as a “prize or award” under N.J.S. 54A:5–1(1).¹⁵ The Division also disallowed deductions for plaintiff’s attorney’s fees, and for payments to other relators pursuant to their joint prosecution and sharing agreement.¹⁶ With penalties and interest, Kite owed \$118,882.52.¹⁷

Kite filed a protest with the Division and requested an administrative conference.¹⁸ After the conference, the Division upheld the assessment, and with additional interest calculated to December 15, 2012, the assessment totaled \$124,476.¹⁹

Relevant Statute

The relevant portion of N.J.S. 54A:5–1 states the following:

New Jersey Gross Income Defined. New Jersey gross income shall consist of the following categories of income:

I. Amounts received as prizes and awards, except as provided in N.J.S.54A:6-8 and N.J.S.54A:6-11 hereunder.

Analysis

The Appellate Division looked to the plain language of N.J.S. 54A:5-1(1), as well as the dictionary definition of “award” and agreed with the trial court that, as used in the statute, “award...is commonly understood to include the monies a person receives as damages in a lawsuit.”²⁰ The Appellate Division noted the Tax Court’s finding that N.J.S. 54A:6-6(b) specifies what may be excluded from gross income tax.²¹ “That statute excludes from gross income ‘the amount of damages received, whether by suit or agreement, on account of personal injuries or sickness.’ ... Thus, the exclusion indicates that the Legislature intended that other monies recovered as damages in a lawsuit or settlement, such as damages in a *qui tam* action under the FCA, would be considered an ‘award’ and gross income under the Act.”²² Both Courts highlighted that the False Claims Act explicitly refers to a recovery in a *qui tam* action as an “award,” as did the

¹¹ *Id.*

¹² *Kite v. Director, Division of Taxation*, 453 N.J. Super. 146, 150.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 150-151.

²⁰ *Id.* at 153.

²¹ N.J.S. 54A:6-6. Compensation for injuries or sickness.

²² *Kite*, 453 N.J. Super. at 153-154.

relators' sharing agreement.²³ The Appellate Division rejected Plaintiff's argument that "a 'prize' is something offered in a competition or contest of chance, and an 'award' is something that is conferred or bestowed especially on the basis of merit or need", suggesting that his interpretation of the words was unduly narrow, and that the definitions on which he relied actually supported the decision below.²⁴ The Appellate Division also rejected the Plaintiff's argument that the New Jersey Gross Income Tax Act "only intended to assess the tax upon income after credit was given for the costs and expenses incurred in the generation of the income", pointing out that the Court below noted

that sixteen categories of income are identified in the Act as gross income, and only a few of those categories are "net income." See N.J.S.A. 54A:5-1(b) ("[n]et profits from business"); N.J.S.A. 54A:5-1(c) ("[n]et gains or income from disposition of property"); N.J.S.A. 54A:5-1(d) ("[n]et gains or net income from or in the form of rents, royalties, patents, and copyrights"); N.J.S.A. 54A:5-1(h) ("[n]et gains or income derived through estates or trusts"); and N.J.S.A. 54A:5-1(p) ("[n]et pro rata share of S corporation income").²⁵

The Appellate Division also agreed with the trial court that deductions on federal income taxes were not controlling.²⁶ The Court noted that any policy considerations that might influence a potential relator, such as whether recoveries in a *qui tam* action should be exempt from taxation, were properly for the Legislature.²⁷

Conclusion

Staff seeks authorization to conduct additional research and outreach to determine whether modifying N.J.S. 54A:5-1 in light of the Court's determination regarding the definition of "award" would add clarity to the statute.

Staff notes that S784/A3614 were introduced in the current legislative session. These bills were intended to provide "a gross income tax exclusion for attorney's fees and costs received in connection with certain unlawful discrimination or unlawful retaliation claims or actions."²⁸ The Senate version of the bill passed both houses of the Legislature but was absolutely vetoed by the Governor in January 2019. The Veto Statement indicated, in part, that the Gross Income Tax was "originally conceived as a tax on gross income, without numerous exclusions or deductions" and that the legislation would likely result in a tax revenue loss to the State.²⁹

²³ *Id.* at 154.

²⁴ *Id.* at 154-155.

²⁵ *Id.* at 155-156.

²⁶ *Id.* at 156.

²⁷ *Id.* at 157.

²⁸ Senate Bill, No. 784, State of New Jersey 218th Legislature, https://www.njleg.state.nj.us/2018/Bills/S1000/784_I1.PDF (last visited 10/04/19).

²⁹ Senate Bill, No. 784, State of New Jersey 218th Legislature, Governor's Veto Statement, https://www.njleg.state.nj.us/2018/Bills/S1000/784_V1.PDF (last visited 10/04/19).